

MASS TORT LITIGATION AND BANKRUPTCY

2003 Third Circuit Judicial Conference
November 10, 2003

I. The Phenomenon of Mass Tort Bankruptcies

A. Not within contemplation of Congress

- When Bankruptcy Code was enacted in 1978, no indication that Congress anticipated use of bankruptcy to resolve mass torts.
- But Code contains features that eventually made it attractive as a remedy for mass tort defendants.

B. Mass tort bankruptcy filings

- UNR and Johns Manville in 1982.
- Other asbestos bankruptcies followed.
- Then A.H. Robins filing in 1985 to resolve Dalkon Shield liability.
- Dow Corning filed in 1995 because of silicone gel breast implant claims.
- Since January 2000 a new wave of asbestos filings. Twenty or more bankruptcy filings since then.

C. Early challenges; then acceptance

- First mass tort bankruptcy filings were vigorously challenged: bad faith, not insolvent, couldn't bind future claimants, no claims if injury not manifest, notice not feasible.
- Over time courts and lawyers found ways to adapt bankruptcy to fit mass tort cases.
- In 1994 Congress amended Bankruptcy Code to include for first time provision expressly dealing with asbestos chapter 11 cases.
- In 1997 National Bankruptcy Review Commission recommended expanded Code treatment of mass tort bankruptcies.
- A subcommittee of U.S. Judicial Conference Committee on the Administration of the Bankruptcy System reviewed the mass tort recommendations of the Review Commission and identified and discussed concerns about the following issues: due process (including both adequacy of notice and adequacy of representation), estimation of tort liability, statutes of limitation and repose, and

conflicts of interest.

- Efforts now in Congress to remove asbestos litigation from the courts, but even if enacted, bankruptcy will remain an option for companies facing massive liability for other products.

II. Why Bankruptcy?

A. Relief for financially distressed debtors

- Defense and settlement of mass tort claims began to threaten economic viability of companies. No end in sight to claims.
- Individual litigation of thousands (or hundreds of thousands) of claims not feasible, and Supreme Court decisions made resolution through federal class action settlements less likely.
- Chapter 11 is the traditional remedy for reorganizing debt and freeing company of liabilities except as provided for in confirmed reorganization plan.

B. Attractive features of bankruptcy

- Consolidation – All claims against the debtor (and perhaps others) are consolidated in one forum. Allows for unified, global resolution.
 - " automatic stay – all pending and future litigation against debtor, collection efforts stopped.
 - " exclusive control of debtor's property – bankruptcy court has exclusive jurisdiction over the bankruptcy estate, wherever located.
 - " therefore tort claimants must look to bankruptcy court for compensation.
 - " expansion of automatic stay – sometimes expanded by bankruptcy court to protect related parties (officers, shareholders, parent companies, insurers) that haven't filed for bankruptcy.
 - " transfer of cases against nondebtors – sometimes co-defendants not in bankruptcy have attempted to get the litigation against them transferred to the bankruptcy court. Mixed results.
- Broad definition of "claim" – Bankruptcy Code has all-encompassing

definition of “claim.” 11 U.S.C. § 101(5).

" May be contingent, unliquidated, disputed, unmatured, not reduced to judgment and still be dealt with in bankruptcy and discharged.

" Arguably broad enough to include the claims of persons exposed to debtor’s product but not yet manifesting any injury (i.e. future claims).

" Possible means of dealing with mass tort liability in its entirety.

- Discharge – No further liability except as provided in reorganization plan.

" Upon confirmation of plan, discharge of all debts arising prior to confirmation.

" Binding on all creditors, even those that voted against plan. No opt outs.

" Some courts have expanded scope of discharge by entering injunctions protective of nondebtor third parties.

C. Goal

- Bankruptcy is means of getting all the mass tort claims—present and future—against the debtor (and perhaps others) into one federal court.

- Once there, negotiation process. Initially debtor has exclusive right to propose plan. Meanwhile creditors not getting paid. Gives debtor significant leverage.

- Individual litigation with risk of multiple punitive damages awards and repetitive defense costs eliminated.

- Preserve going concern value of the debtor so as to maximize value of the reorganized company, with a distribution of that value to creditors (including present and future tort claimants) and (possibly) equity holders.

III. Special Issues in a Mass Tort Bankruptcy

A. Division of responsibility between bankruptcy and district judges

- Special treatment of personal injury tort and wrongful death claims required by 28 U.S.C. § 157.

- As result, sometimes district judge withdraws reference and exercises jurisdiction over mass tort aspects of the bankruptcy case; sometimes bankruptcy judge retains all jurisdiction.

- Creates need for communication and coordination between judges. Also clarification of capacity in which judge is acting.

B. Appointment of committees

- These are the key negotiating agents.

- Instead of just one unsecured creditors committee, usually separate committees for commercial creditors (banks, bondholders, trade creditors) and tort claimants.

- Sometimes plaintiffs' attorneys as committee members rather than the tort claimants themselves.

- Sometimes more than one tort claimants' committee.

C. Appointment of future claims representative

- Not originally provided for in Bankruptcy Code. Judicial solution for what to do about future claimants who would necessarily be affected by the bankruptcy. Needed a voice.

- Code now requires for asbestos chapter 11 bankruptcies if channeling injunction is to be entered. 11 U.S.C. § 524(g).

- One future claims representative for all future tort claimants. Acts as voice, negotiator, litigant on their behalf.

D. Bar date

- Deadline for filing tort proofs of claim in the bankruptcy case.

- Defines universe of present claims and who's entitled to vote on plan. May or may not limit who ultimately gets paid.

- Generally not applicable to future claimants.

- Used as means of gathering information about the tort claims (exposure, injuries, proof). Special claims forms may be used.

- Extensive notice program required. Nationwide or even worldwide. Inform

known and unknown claimants of need to file proof of claim by certain date; otherwise possibly no payment.

E. Attempt to (re)litigate merits of claims

- Debtor (or others) may seek to eliminate large groups of claims based on various defenses or may even challenge whether product caused illnesses asserted.
- Tort claimants seek payment based on historical (prebankruptcy) settlement values.
- Courts have generally declined to rule on merits of claims; have left to parties' negotiations.

F. Negotiation over terms of reorganization plan

- Key parties initially are debtor, tort claimants' committee, future claims representative, insurer. Then unsecured creditors' committee (and equity).
- Sometimes assisted by mediator, examiner.
- Issues: ratio of tort debt to commercial debt, whether there's any value left for shareholders, allocation among tort claimants (personal injury vs. property damages, present claims vs. future claims, malignant injuries vs. nonmalignant), means of funding payments to tort claimants (including insurance coverage)

G. Estimation of tort claims

- Need to determine dollar amount of aggregate tort liability. Bankruptcy Code allows for "estimation" of claims where liquidation would unduly delay administration of bankruptcy case. 11 U.S.C. § 502(c).
- Can either be part of parties' negotiating process or result of judicial estimation.
- Generally based on historical settlement values and epidemiological data about future incidence of claims. Value of individual claims not determined.

H. Resolution of insurance issues

- Significant because debtor's insurance is needed to fund payment of tort claims and to ensure plan's feasibility.
- Are rights to insurance proceeds assignable to tort claimants' trust despite

policy's anti-assignment clause?

- May plan impose settlement processes for payment of tort claims by means of matrices, etc., in face of provisions dealing with insurers' rights to consent to settlement, cooperation, no-action or management of claims contained in policies or insurance-in-place settlement agreements?
- Can these insurance issues be resolved at plan confirmation hearings, or do they require separate state or federal court litigation or bankruptcy adversary proceedings?

I. Confirmation of reorganization plan

- Disclosure statement approved, creditors and shareholders permitted to vote on whether to accept plan, confirmation hearing. Value of tort claims set for voting purposes only (in some cases each valued at \$1).
- Special confirmation rules for asbestos chapter 11 cases. If followed, allows for entry of "channeling injunction" requiring tort claimants to seek payment only from trust. Protects reorganized debtor and others. 11 U.S.C. § 524(g).
- Under § 524(g) trust must be funded with majority of voting shares of debtor's securities, at least 75% of tort claimants who vote must accept plan, present and future tort claimants must be paid in substantially the same manner, future claims representative must have been appointed, and district court must either issue or affirm issuance of channeling injunction before it becomes effective.

J. Payment of tort claims through trust mechanism

- Typically several payment options: early payment of claims liquidated before bankruptcy, quick and low payment of claims for a set amount, individual determination of claims with settlement offer and possible litigation or arbitration.
- Payment percentage established and periodically adjusted to preserve funds for future claims.

K. Alternative to the above: prepackaged bankruptcies

- Key players: debtor, claimants' representative, futures' representative, third parties, insurers, mediator.
- Solicitation of acceptances by tort claimants prior to bankruptcy through law firms.

- Bankruptcy filing upon 75% acceptance.
- Reliance upon 11 U.S.C. § 1126(b)'s allowance of prepetition solicitation and acceptance.
- Compensation of tort claimants pursuant to trust mechanism.
- Resolution of insurance issues through settlement or litigation.

IV. What's Been the Result of Mass Tort Bankruptcies?

A. Mixed results in trust performance

- Johns Manville trust ran out of funds due to larger than assumed number of claims and higher payouts. Eventually trust was restructured.
- Robins trust ended up paying claims "in full" and having additional money to distribute.

B. Relatively low payments

- Manville trust is now paying only 5% of liquidated amount of claims.
- More than 132,000 Dalkon Shield claimants selected \$725 flat sum option from Robins trust.
- Initial payment amount from Eagle-Picher trust was 27.8% of liquidated amount.

C. Lengthy wait until payment

- Some Dalkon Shield claimants who didn't select flat sum option had to wait thirteen years from commencement of bankruptcy until receiving compensation for serious injuries.
- UNR trust didn't start making payouts until almost ten years after commencement of bankruptcy.

D. Elimination of litigation costs, preservation of funds for future claimants

E. Increase in volume of claims

F. Multiple sources of payment: other trusts, search for defendants not in bankruptcy

(does that raise issues of causation, preclusion or estoppel?)

G. Precipitation of other bankruptcies

V. What Are the Lingering Concerns About Mass Tort Bankruptcies?

A. Due process concerns

- Can adequate notice be given to future as well as present claimants?
- Can future claimants without any notice of the bankruptcy be bound by the plan?
- Does the participation of a future claims representative make up for lack of notice? Is one representative for all future claimants adequate?

B. Estimation of tort liability

- Can the value of future tort claims be accurately estimated?
- Should estimation be based primarily on historical settlement values?
- Does estimation deprive parties of jury trial rights?

C. Scope of bankruptcy relief

- Should the automatic stay and discharge injunction (or channeling injunction) provide protection for parties that don't file for bankruptcy?
- Should nondebtor co-defendants be permitted to remove the litigation against them to the debtor's bankruptcy court?

D. Cost and delay

- Are there ways to reduce the time for confirming a reorganization plan and commencing payments to tort claimants?
- Can efficiencies be achieved by consolidating the trust payment mechanisms of several asbestos debtors?
- Can expeditious pay-out mechanisms be devised that don't encourage the filing of large numbers of low merit claims?

E. Alternatives to bankruptcy

- Can the best features of bankruptcy be incorporated into mass tort resolution and payment schemes in non-bankruptcy courts or in administrative forums?